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March 9, 2001

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BYHAND

The Honorable David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

New York Independent System Operator, Inc's
Request for Extension of Temporary Extraordinary Procedures

Dear Mr. Boergers:

The New York Independent System Operator, Inc. ("NYISO"), by counsel, hereby files to extend until the end of the 2002 Summer Capability Period,¹ *i.e.*, until October 31, 2002, its Temporary Extraordinary Procedures for Correcting Market Design Flaws and Addressing Transitional Abnormalities ("TEP"). The TEPs that the NYISO seeks to extend without modification are set forth in Attachment Q to the NYISO's Open Access Transmission Tariff ("OATT") and Attachment E to its Market Administration and Control Area Services Tariff ("Services Tariff") (which are identical). The Commission previously extended the TEPs in a November 21, 2000 order in Docket No. ER01-94-000.²

In a number of recent filings, the NYISO has demonstrated that it has made great strides towards eliminating market design and software flaws in the energy markets it administers.³ As a

¹ Capitalized terms not otherwise defined herein are defined in Article 2 of the NYISO's Market Administration and Control Area Services Tariff.

² *New York Independent System Operator, Inc.*, 93 FERC ¶ 61,187 (2000).

³ *See New York Independent System Operator, Inc.*, 93 FERC ¶ 61,142 (2000) ("November 8, 2000 Order"). In the November 8, 2000 Order, the Commission acknowledged the NYISO's progress in correcting several software and design flaws, as specified by the NYISO in its September 1, 2000 Combined Compliance Filing and Report (as modified on September 8, 2000), as well as in comments filed on November 3, 2000, in the same proceeding. The NYISO's market design and software improvements were also described in its materials and presentations at the January 22 and 23, 2001 NYISO technical conference convened pursuant to the November 8, 2000 Order.

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result, the NYISO has had to intervene in the markets less frequently than in the early days of NYISO operations, which has created greater price certainty for Market Participants.

Nevertheless, the existing imbalance between the supply of and the demand for electricity in New York is likely to continue for some time because of siting and licensing delays will slow the development of new generation, transmission facilities and gas pipelines.⁵ Given the anticipated tightness of supply in New York, the margin for market errors is very small. Minor market design flaws can have extremely serious price and reliability consequences. It is possible that such market design flaws still exist and will not be detected until the NYISO markets experience the stresses of typical summer air conditioning loads, which were not encountered in 2000,⁴ or that new market design flaws will arise as the NYISO implements market improvements or adopts new rules in response to the needs of its Market Participants. The NYISO should therefore have the ability to effectively address such flaws until such time as it becomes clear that new rules and improvements will not have adverse consequences and the supply situation begins to improve. The NYISO estimates that this will take at least 18 months. The NYISO anticipates that occasions when it must exercise its TEP authority will be increasingly rare during this transitional period and has no intention of intervening in the markets unnecessarily.

Documents Submitted

Pursuant to Section 205 of the Federal Power Act and 18 C.F.R. § 35.13 (2000), the NYISIO is filing six copies of:

1. This filing letter;

⁵ While licensing and siting procedures outside of the NYISO's control have proven to be a developmental bottleneck for new supplies, Market Participants have announced their intentions to build almost 33,000 MW of new generation in New York. This demonstrates that the existence of the NYISO's limited market protective measures, including the TEPs, has not discouraged the entry of new supply.

⁴ The New York Control Area ("NYCA") experienced an exceedingly cool summer in 2000. For example, statewide temperatures during the New York system's highest peak demand day during the summer of 2000, which occurred on June 26, were in the bottom 10% of peak day temperatures based on 51 years of historical weather data. Indicative of the reduced demand for air conditioning-related loads, actual cooling degree days for the summer of 2000 were only 52% of what would be expected during an average summer air conditioning season.

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2. A clean revised copy of Attachment Q to the NYISO's OATT -- setting forth the TEP tariff provisions with the NYISO's proposed October 31, 2002 expiration date) ("Attachment A-1");
3. A clean revised copy of Attachment E to the Services Tariff -- setting forth the TEP tariff provisions with the NYISO's proposed October 31, 2002 expiration date) ("Attachment A-2"); and
4. A draft *Federal Register* Notice ("Attachment B").

Copies of Correspondence

Communications regarding this proceeding should be addressed to:

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Parties on Whom Copies Have Been Served

Copies of this filing have been served on the parties in Docket No. ER00-2624-000, on those parties who have executed service agreements under the NYISO OATT or the NYISO Services Tariff and on the electric utility regulatory agencies in New York, New Jersey, and Pennsylvania.

Request for a TEP Extension

As would be expected in a newly designed and implemented energy market that integrates both day-ahead and real time energy markets with several ancillary services markets, the NYISO has identified and rectified a number of software problems, unforeseeable market flaws, and other unexpected anomalies during its initial year of operation. The TEPs were, and remain, an

indispensable tool for responding to and correcting market flaws and other instances where the markets are not operating as the NYISO and the Commission intended.

As initial market design flaw and problems have been addressed, the NYISO's necessary intrusions into the New York energy markets have been dramatically reduced. Indicative of the NYISO's carefully measured use of the TEP authority, the seven original Emergency Corrective Actions ("ECAs") issued under the TEP were reduced to three in a relatively short period of time. The NYISO has subsequently issued just three ECAs, "ECA A,"⁶ "ECA B,"⁷ and an ECA which eliminated artificial bidding restrictions applicable to certain types of suppliers. In each instance, the ECA functioned as intended. Moreover, to the extent that ECAs have necessitated permanent tariff changes, Market Participants have supported the development of such changes, further indicating that the NYISO has invoked its TEP authority only in cases where it was appropriate.

The number of price corrections is also falling dramatically. At the January 2001 Technical Conference, the NYISO reported that price corrections during the year 2000 were limited to just 2.92% of all Security Constrained Dispatch ("SCD") intervals⁸. For January and February, 2001, price corrections were made in just 0.06% of SCD intervals. In fact, reflecting the continuing improvement in market performance under the NYISO's oversight, 190 operating days during 2000 required no price correction whatsoever. In January and February 2001, 51 days required no price corrections. Another indication of increased price certainty for Market Participants in New York, price corrections in the Day-Ahead market, which establishes an

⁶ "ECA A" eliminated Market Participants' incentive to enter into "sham" external transactions in order to game the differences in the results produced by the NYISO's Balancing Market Evaluation ("BME") and Security Constrained Dispatch programs. Prior to the issuance of ECA A, such sham transactions were creating serious transaction scheduling problems for the NYISO.

⁷ "ECA B" provides that transactions will be settled at the BME price when constraints are binding in the BME at external interfaces. It therefore ensures that congestion costs at external proxy buses will be properly reflected in real-time prices and substantially reduces the risk that accepted day-ahead transactions would be cut by the BME at one price, forcing Market Participants to settle at a much different real-time price. ECA B has also facilitated the NYISO's scheduling of counter-flow transactions which has enhanced its ability to provide firm transmission service.

⁸ Each SCD interval is generally six minutes in duration. Thus, an operating hour normally contains 10 SCD intervals.

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energy price and a generation schedule for each hour of the 24 hour operating day, were limited to just 0.4% of the 8,760 operating hours of the year 2000.

Going forward, the NYISO anticipates that the possibility of unexpected market design problems or anomalies will always be present to some extent. Even as its markets mature, the NYISO will continue to implement software or market improvements, whether from improved technology, new market products, or requests for market changes from Market Participants. For example, the NYISO plans to implement demand-side responsive mechanisms for price responsive loads and plans to enhance liquidity in the New York energy markets through initiatives such as virtual load bidding. Some of these market enhancements are scheduled for implementation after this summer. As has been the NYISO's experience, despite extensive pre-operational testing, the implementation of such major initiatives will likely uncover unforeseeable market problems that can most effectively be addressed through the exercise of TEP authority. The NYISO is particularly concerned that the effects of even a limited number of future market flaws will be greatly exacerbated until such time as New York State's supply situation improves. The NYISO, therefore, continues to need the authority provided under the TEPs as a means to take prompt action.

It is apparent that New York State's energy supply-related infrastructure, *i.e.*, electric generation and transmission and natural gas pipeline capacity, faces critical challenges. In the near term, the addition of new generating resources in amounts adequate to meet growing demands appears to be insufficient both within specific parts of the state and throughout the state as a whole. In its recently released *Locational Installed Capacity Requirements Study*, for example, the NYISO concluded that the New York City area is almost 400 MW short of installed locational generating capacity required to meet applicable reliability standards for the Summer 2001 Capability Period. While the gas turbines that the New York Power Authority intends to install in the New York City area prior to summer will help to improve reliability, these units are insufficient to fully support competitive markets under high load conditions in New York City. The NYISO is also concerned that the siting of these units faces stiff local opposition, including civil lawsuits in state court, which could delay their completion.

For New York State as a whole, the 18% installed reserve reliability requirement is being met, albeit in large part through increased reliance on out-of-state resources. Between 1995 and 2000, statewide demand for electricity grew by 2,700 MW, while generating capacity increased by only 1,060 MW. Although 85 new generating projects have been proposed or announced for New York representing almost 33,000 MW of new generation in total, only two of these planned projects has even completed the lengthy and contentious state licensing process. In the meantime, electricity demands continue to increase at the rate of approximately 1.4% annually

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and are expected to continue to do so over the next few years. In addition to the important reliability questions raised by the tightness of supply, the NYISO is particularly concerned that diminishing supplies of hourly generation and generation reserves will make the NYISO-administered markets vulnerable to artificial price spikes, or gaming when unexpected market flaws arise.

As the Commission is well aware, adequate transmission capacity has long been a concern in New York State. It has always been difficult to move the more abundant and less costly energy supplies from upstate New York down to the more supply constrained downstate area, principally due to capacity and operating constraints at the New York Control Area's Central-East interface. Unfortunately, no major improvements in either capacity or operating limitations are currently planned at Central-East, reflecting the fact that the addition of new transmission capacity anywhere in New York is fraught with obstacles. Right of way acquisition is difficult and costly and the siting of transmission lines typically faces even more opposition than proposed generating projects.

Non-electric infrastructure is of equal concern to the NYISO. Much of New York's existing generation base is fueled by natural gas. Moreover, the vast majority of planned additions to generation will be fueled by natural gas. Nevertheless, during the winter heating season residential heating needs take a priority for most of the available interstate gas pipeline capacity. Consequently, additional pipeline capacity will be required if the new additions to electric generating supply that are natural gas-fueled are to be able to operate year around. As with capacity additions for electric generation and transmission, however, planned enhancements to interstate gas pipeline capacity appear to fall well short of what will be needed in the near term for new electric generation in New York.

Electric supply constraints, therefore, will continue to strain the NYISO-administered energy markets in New York. The few remaining market flaws that have yet to be corrected , as well as yet to be detected situations that may appear while future market improvements are implemented could have major adverse consequences on Market Participants in an environment of limited supplies. It is all the more important for the NYISO to continue to have at its disposal a tool that will enable it to respond as quickly as possible. The NYISO strongly believes that the currently effective TEPs continue to be that tool and, in the NYISO's estimation, this authority will continue to be necessary until the end of the Summer 2002 Capability period. The NYISO is hopeful that, by that time, significant progress will also have been made towards addressing tight supply conditions in New York.

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Granting a TEP extension will not result in extensive changes to posted prices. While some price corrections in the real time market are inevitable to some degree, as discussed above, such corrections are becoming less frequent. Moreover, the NYISO already has price correction authority under the filed rate doctrine and the TEPs simply provide a well-defined procedural framework for the exercise of this authority when market flaws are detected. Price certainty will be further enhanced when the improvements to the price correction process outlined by the NYISO at the Technical Conference are completed. These planned improvements will greatly shorten the time frame for the correction process, which has been one of the primary price certainty concerns of the Market Participants.

In addition, the ability to take an issue-specific Emergency Corrective Action under the TEPs is an important backstop for the NYISO while the energy market under its administration remains capacity constrained. The robust competition that will flow in a market with adequate supplies and reserves will ultimately lessen the need for NYISO intervention and the need for the TEPs. In the meantime, the NYISO has demonstrated that ECAs can be successfully used and have been used only rarely as noted above. Any fears by Market Participants that the NYISO will abuse the price correction authority afforded to it by the TEPs in the future are unfounded. Finally, the NYISO has no substitute for the current TEPs and its ability to issue ECAs when necessary. Absent the TEPs, the NYISO would have to obtain the approval of its independent Board of Directors to submit an exigent circumstances tariff filing whenever a new market flaw arises, which cannot always be accomplished quickly. Board approval cannot always be obtained as quickly as the NYISO staff can develop and issue an ECA. Moreover, once an exigent circumstances filing is made, the NYISO would have to either await Commission approval of the filing, and allow the market flaw to go uncorrected until such time as the Commission issued an order, or make the filing effective prior to Commission approval, which poses legal risks and engenders great controversy. In short, the NYISO needs the flexibility that the TEPs provide to address market flaws effectively.

Based on the foregoing, the NYISO requests Commission approval to extend the effective date of its currently authorized TEPs until October 31, 2002.

Stakeholder Approval

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This request to extend the effective date of the Temporary Extraordinary Procedures was approved by the Management Committee of the NYISO with a 62.49% vote in favor⁹ at its Meeting on March 1, 2001, pursuant to the provisions of Section 19.01 of the NYISO's Independent System Operator Agreement.

Effective Date and Request for Waiver

The NYISO requests an effective date of May 1, 2001, the day following the expiration of the currently approved Temporary Extraordinary Procedures and respectfully requests a waiver of the Commission's normal 60-day notice requirement. The NYISO submits that the requisite "good cause" exists for a waiver because the TEP authority is necessary to ensure that the NYISO-administered markets avoid serious problems this Summer. Moreover, the Management Committee meeting, at which this issue was most recently discussed, did not take place until March 1, 2001.

Federal Register Notice

A form of Federal Register Notice is provided as Attachment B hereto. A diskette of the notice is also provided.

⁹ 58% is required for approval.

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Respectfully submitted,

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